# Profile of the Economy

[Source: Office of Macroeconomic Analysis]

As of February 17, 2020

**Introduction**

U.S. economic growth maintained its momentum through the end of 2019 and into early 2020, despite a number of headwinds, bringing the record-long recovery into 128th month as of February 2020. The economy continues to perform well with solid job creation, an unemployment rate near a 50-year low, faster growth in nominal and real wages, modest inflationary pressures, elevated business and consumer sentiment, and consolidating gains in the housing sector. According to the advance estimate, real GDP grew 2.1 percent at an annual rate in the fourth quarter, matching the pace in the third quarter. Growth over the four quarters of 2019 was 2.3 percent, only marginally slower than 2018’s 2.5 percent pace. As of early February, private forecasters predicted that growth on a Q4-over-Q4 basis would be 1.9 percent in 2020, and 1.9 percent in 2021. However, the Administration foresees growth nearing 3 percent in the next few years, as the enactment of its pro-growth policies, combined with the fading of temporary headwinds lead to renewed business investment and stronger productivity growth.

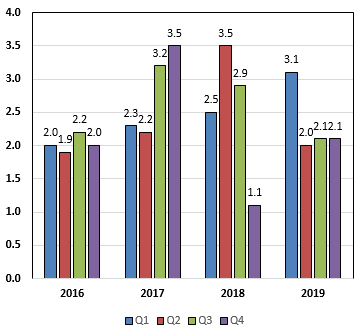
**Economic Growth**

Real GDP increased by 2.1 percent at an annual rate in the fourth quarter, according the advance estimate, following an identical pace of growth in the third quarter. Over the four quarters through 2019 Q4, the economy expanded by 2.3 percent, slowing only marginally from the 2.5 percent pace over the previous year. The economy demonstrated significant resilience during 2019, in the face of such headwinds as slowing global growth, a labor dispute at General Motors, and the grounding of the Boeing 737 MAX aircraft. Notably, the Council of Economic Advisors estimates that growth over the four quarters of 2019 would have been about 0.2 percentage points higher but for the production cuts at Boeing. Growth of private domestic final purchases – the sum of personal consumption, business fixed investment, and residential investment – decelerated to 1.4 percent during the fourth quarter from 2.3 percent in the third quarter, being hindered by slower growth in personal consumption expenditures.

Real consumer spending slowed to 1.8 percent in the fourth quarter, after rising 3.2 percent in the third quarter and surging 4.6 percent in the second quarter. Purchases of services and durable goods drove fourth quarter growth in real consumption, rising 2.0 percent and 2.1 percent, respectively. Yet consumption of nondurable goods increased only 0.8 percent in the fourth quarter. On balance, real personal

**Growth of Real GDP**

(Quarterly percent change at annual rate)

consumption expenditures in Q4 added 1.2 percentage points to growth, making the second-largest contribution of any component of GDP.

Although business fixed investment again constrained GDP growth, it posed only a modest drag in the fourth quarter, subtracting 0.2 percentage point from real GDP. Total business fixed investment declined 1.5 percent in the fourth quarter, less than the 2.3 percent decrease in the previous quarter. Equipment investment was down 2.9 percent, also tapering a bit from the third quarter’s 3.8 percent decline. Spending on structures fell 10.1 percent, about in line with declines in the previous two quarters. Lower structures investment was broadly based – from decreased investment in oil and gas drilling rigs to fewer expenditures on commercial and health care structures. In contrast to equipment and structures investment, expenditure on intellectual property products, considered key to innovation and future economic growth, has been consistently solid for the past several quarters. This category of business investment even accelerated in the final quarter of 2019, picking up to 5.9 percent after gaining 4.7 percent in the third quarter.

Notably, the change in private inventories posed the largest drag on economic growth in the fourth quarter, subtracting 1.1 percentage points. Albeit a volatile component, the sharp decline in private inventory investment in the fourth quarter was largely due to a significant decrease in inventories at motor vehicle dealers, reflecting in part retailers’ inability to replace inventories during the labor strike at General Motors from mid-September to late October.

After several quarters of retrenchment, residential investment activity improved in the second half of 2019, making small positive contributions to real GDP growth. In the fourth quarter, residential investment advanced 5.8 percent – extending the 4.6 percent gain in the third quarter – and added 0.2 percentage point to GDP growth. The stabilization and improvement in the housing sector has been widespread. Existing home sales, which account for 90 percent of all home sales, rose to a near two-year high in December and were almost 11 percent higher over the past year. New single-family home sales rose to a 12-year high last September and, after retracing a bit, were 23 percent higher on the year through December. Strong sales growth has weighed on inventories of homes available for sale, which remain at relatively low levels. However, new construction is rising and builders are confident in the sector’s outlook: total housing starts surged by almost 17 percent in December, and the National Association of Home Builders’ Home Builder Confidence Index rose in December to its highest level since June 1999, before edging down one point in January. Moreover, house affordability continued to improve in 2019, with 12-month home price growth rates slowing significantly, and mortgage rates easing to about 1¼ percentage point below levels in mid-November 2018.

Total government spending rose 2.7 percent at an annual rate in the fourth quarter, accelerating from the 1.7 percent pace in the third quarter. Federal outlays rose 3.6 percent in the fourth quarter, picking up from a 3.3 percent increase in the third quarter. State and local government spending has been growing more consistently since the end of 2017 and accelerated to 2.2 percent in the fourth quarter, after advancing 0.7 percent in the third quarter. Altogether, government spending added 0.5 percentage point to real GDP growth in the fourth quarter.

The U.S. trade deficit narrowed significantly in the fourth quarter of 2019, as export growth accelerated for the second consecutive quarter and import growth turned sharply negative. Thus, after posing a drag on growth in the second and third quarters, net exports made the largest contribution of any component of GDP, adding 1.5 percentage points to real economic growth in the fourth quarter.

**Labor Markets and Wages**

The unemployment rate has remained at or near a half-century low since September 2019. In December 2019, the unemployment rate stood at 3.5 percent, the lowest rate since December 1969, then edged up to 3.6 percent in January 2020, entirely due to rising labor force participation. The Tax Cuts and Jobs Act (TCJA) continues to help draw workers back into the labor force, and in numbers that have helped offset the downward pressure on participation from the aging population. In January, the overall labor force participation rate (LFPR) rose to 63.4 percent, its highest level since June 2013, and the prime-age LFPR increased to 83.1 percent, its highest level since September 2008.

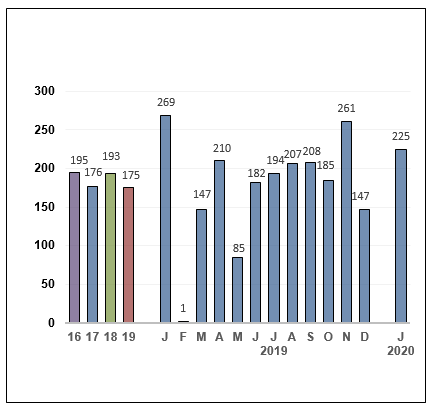
Broader measures of unemployment have also continued to improve in recent labor reports. The most comprehensive measure of labor market slack, the U-6 unemployment rate, which includes those marginally attached to the labor force and those working part-time for economic reasons, declined to a series low of 6.7 percent in December before edging up to 6.9 percent in January. The unemployment rate of those unemployed for 27 weeks or more, as a share of the unemployed, fell to an 11-year low of 19.2 percent last July, before rising modestly to 19.9 percent in January 2020.

Meanwhile, job creation has continued at a solid pace. In 2019, the economy added an average 175,000 payroll jobs per month, a slower pace than the 193,000 monthly average in 2018 but more than sufficient to absorb new entrants into the labor force and maintain a stable unemployment rate. In January 2020, the economy added 225,000 payroll jobs, among the strongest monthly gains in a year.

Rapid wage gains have been a consistent feature of the economy for the past 18 months. Private-sector production and nonsupervisory workers have seen wage increases at or above 3.0 percent for the past year and a half, and during the most recent 12 months, gains have accelerated to a range of 3.2 percent to 3.8 percent. Over the 12 months through January, nominal wages for these workers grew 3.3 percent, in line with the 3.4 percent pace a year earlier. Using the CPI‑W to deflate the nominal rate, real average hourly earnings for private production and nonsupervisory workers grew 1.0 percent over the year through December 2019 (latest data available), slowing from the 1.6 percent advance over the previous 12-month period, but markedly faster than the 0.3 percent rise two years earlier.

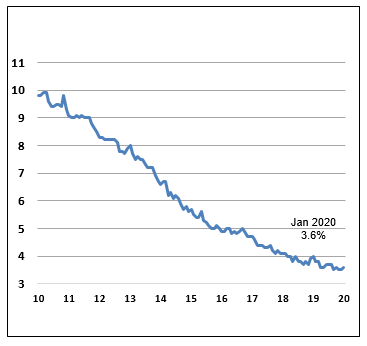
**Payroll Employment**

(Average monthly change in thousands between quarters)



**Unemployment Rate**

(Percent)



**Nonfarm Productivity of Labor**

For the past thirteen quarters, four-quarter nonfarm labor productivity growth rates have remained above 1 percent, a consistency not seen since 2004. Over the four quarters through 2019 Q4, productivity growth rose by 1.8 percent, matching Q2 for the fastest four-quarter advance since 2015 Q1. Productivity rose by 1.4 percent at an annual rate in the fourth quarter, reflecting a 2.5 percent increase in output and a 1.1 percent rise in worker hours. This followed a decline in third quarter productivity of 0.2 percent at an annual rate, as a 2.3 percent increase in output was more than offset by an unusually sharp rise in worker hours of 2.5 percent. The third quarter’s rise in hours worked partly reflected unusual increases in the hours of nonfarm non-employees, a volatile sub-component of worker hours; notably, self-employed hours rose 5.8 percent in the third quarter, but declined 0.4 percent in the fourth quarter.

Hourly compensation costs in the nonfarm business sector rose 2.8 percent at an annual rate in the fourth quarter, accelerating from the third quarter’s 2.3 percent pace. Over the most recent four quarters, hourly compensation costs rose 4.2 percent, the fastest four-quarter advance since 2012 Q4. Unit labor costs, defined as the average cost of labor per unit of output, rose 1.4 percent at an annual rate in the fourth quarter, following a 2.5 percent increase in the third quarter. These costs were up 2.4 percent over the latest four quarters, the fastest increase since 2018 Q1.

Another measure, the Employment Cost Index (ECI), provides perspective on growth of the main components of compensation. Private wages and salaries grew by 3.0 percent over the 12 months through December 2019; growth of this measure has remained at or above the 3.0 percent mark for six consecutive quarters, a first since 2007.

**Industrial Production, Manufacturing and Services**

A variety of measures of industrial production, manufacturing, and services output trended lower in 2019 after reaching multi-year highs the previous year.

Industrial output at factories, mines, and utilities declined 0.5 percent at an annual rate in the fourth quarter of 2019, partially offsetting a 1.2 percent advance in the third quarter. Over the 12 months ending in December, output was down 1.0 percent.

Manufacturing production, which accounts for about 75 percent of all industrial output, declined 1.0 percent at an annual rate in the fourth quarter of 2019, following a 0.8 percent advance in the third quarter. The fourth quarter was noteworthy for continued strength in the output of selected high-technology industries (up 7.5 percent) as well as aerospace and other transportation equipment (up 6.6 percent), but also for a 14.0 percent plunge in the production of motor vehicles and parts. The decline in auto production resulted, at least in part, from the UAW strike at General Motors in September and October. Manufacturing output was down 1.3 percent over the 12 months through December. Excluding motor vehicles and parts and high-technology industries, manufacturing edged down 0.1 percent at an annual rate during the fourth quarter and was down 1.0 percent over the year through December.

Output at mines, which includes crude oil and natural gas extraction and accounts for 15 percent of industrial output, rose 1.9 percent at an annual rate in the fourth quarter of 2019, following a 2.0 percent decline in the third quarter. Over the 12 months through December, mining output rose 1.4 percent.

Utilities output, the remaining 10 percent of total industrial output, edged down 0.3 percent at an annual rate in the fourth quarter, after jumping 8.8 percent in the third quarter. Weather is usually a factor contributing to swings in this sector; unseasonable weather in quarters often causes sharp swings in output from one period to the next. Over the 12 months through December, utilities production decreased 1.9 percent.

Other measures of manufacturing and services production in the economy have declined noticeably from 2018’s multi-year highs. In 2018, the Institute of Supply Management’s (ISM) manufacturing index averaged 58.8, but in 2019, the average declined to 51.2. For five consecutive months towards the end of 2019, the index remained below the 50-point growth threshold – the first multi-month contraction signal for the manufacturing sector since early 2016. In January 2020, however, the ISM manufacturing index rose 3.1 points to 50.9, again signaling modest growth. In the service sector, the ISM’s non-manufacturing index averaged 59.0 points in 2018, and the average edged down to 55.5 in 2019. In January 2020, the non-manufacturing index rose 0.6 point to 55.5, pointing to continued expansion in business service activity at a pace in line with the 2019 average, albeit slower than that in 2018.

**Prices**

For much of 2019, headline consumer price inflation decelerated, reflecting decreasing energy prices, but towards the end of that year, some measures of inflation picked up as energy prices began to recover. Despite this acceleration, inflation remains relatively moderate: over the 12 months through December 2019, the Consumer Price Index (CPI) for all items rose 2.3 percent, above the 1.9 percent pace a year earlier. After seven consecutive months of year-over-year declines, energy prices rose 3.4 percent over the 12 months through December 2019, a noticeable reversal from the 0.3 percent decline over the previous year. Food price inflation picked up modestly, rising 1.8 percent over the year through December 2019, compared with the 1.6 percent, year-earlier advance. In contrast, core inflation, which excludes food and energy, was relatively steady for much of 2019. Core CPI was 2.3 percent over the year through December 2019, a touch faster than the 2.2 percent pace of a year earlier. Another measure, the headline Personal Consumption Expenditures Price Index (PCEPI, the preferred measure for the FOMC’s 2 percent inflation target) has held below the target since November 2018. The 12-month headline PCEPI slowed to 1.6 percent over the 12 months through December 2019, from 1.8 percent over the year through December 2018. Core PCEPI was also 1.6 percent over the year through December 2019, decelerating from the 2.0 percent pace over the year-earlier period.

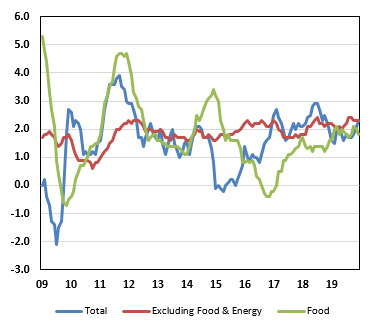
In the housing sector, 12-month measures of house prices slowed to multi-year lows but have since recovered somewhat. However, growth in house prices still exceeds core inflation and income growth measures. The FHFA purchase-only home price index stood at 4.9 percent over the year through December 2019, the slowest 12-month pace in nearly four years. On a 12-month basis, the Standard and Poor’s (S&P)/Case-Shiller composite 20-city home price index decelerated to a seven-year low last summer, but accelerated to 2.6 percent over the year through December.

**Consumer and Business Sentiment**

Measures of consumer and business sentiment remain elevated, and in recent months, have trended upwards toward 2018’s multi-year highs. In January, the Reuters/Michigan consumer sentiment index rose 0.5 points to 99.8, or within 1.6 points of the 14-year high of 101.4 reached in March 2018. Notably, this index averaged 98.4 per month in 2018, the highest monthly average for any year since 2000; the average moderated to 96.0 during 2019. The Conference Board’s confidence index increased 3.4 points to 131.6 in January, or 6.3 points below the 18-year high of 137.9 reached in October 2018. The National Federation of Independent Business’s (NFIB) small business optimism indexdeclined 2.0 points to 102.7 in December, only 6.1 points below the record high of 108.8 reached in August 2018.

**Consumer Prices**

(Percent change from a year earlier)



**Federal Budget and Debt**

The Federal Government posted a deficit of $984 billion (4.6 percent of GDP) in FY 2019, rising from $779 billion (3.8 percent of GDP) in FY 2018. The primary deficit (which excludes net interest payments) was 2.9 percent of GDP in FY 2019, up 0.7 percentage point from FY 2018.

Federal receipts totaled $3.46 trillion (16.3 percent of GDP) in FY 2019. Although the level of receipts was $133 billion higher than last year, receipts’ share of the economy declined from 16.4 percent of GDP in FY 2018. Net outlays for FY 2019 were $4.45 trillion (21.0 percent of GDP), up from 20.3 percent of GDP in FY 2018. Federal debt held by the public, or federal debt less the debt held in government accounts, rose from $15.75 trillion at the end of FY 2018 to $16.80 trillion by the end of FY 2019, or 79.2 percent of GDP.

The Administration’s Budget for Fiscal Year 2021 was released in February 2020. The Administration projects the federal deficit will rise to $1.08 trillion (4.9 percent of GDP) in FY 2020. From FY 2021 to FY 2025, the deficit would total $3.71 trillion (2.9 percent of GDP, on average). The projection assumes implementation of the Administration’s proposals – such as increasing spending on national defense, supporting major infrastructure investment, cutting non-defense discretionary outlays, and reforming health care, drug pricing, welfare programs, student loans, and the Postal Service – which would reduce the 10-year deficit relative to the baseline by $5.21 trillion. On net, these proposals would gradually reduce the deficit to $261 billion (0.7 percent of GDP) by FY 2030. The Budget expects that the primary deficit (which excludes net interest outlays) will be 3.2 percent of GDP in FY 2020, which will turn into a small primary surplus by FY 2026. Debt held by the public would peak at 81.3 percent of GDP in FY 2022 but would gradually decline to 70.0 percent of GDP by FY 2029.

The President’s Budget assumes a lower level of discretionary spending in FY 2021 than was agreed in the Bipartisan Budget Act (BBA). The BBA lifted spending caps established in 2011 and allowed for $1.3 trillion in defense and non-defense discretionary spending over the next two fiscal years. The BBA also suspended the Treasury’s borrowing limit until July 31, 2021. As of January 2020, gross federal debt was $23,224.8 billion, while federal debt held by the public totaled $17,212.6 billion.

**Economic Policy**

In December 2017, the United States enacted TCJA, the first major tax reform in three decades. Combined with regulatory reforms, the revised tax code is designed to strengthen incentives for economic growth through investment, which should support a sustained increase in productivity, and improved labor force participation. The tax law lowered the U.S. corporate tax rate from one of the highest in the developed world to near the average of other advanced economies; it allowed businesses to deduct immediately 100 percent of the cost of most of their new capital investments for the next five years. TCJA also delivered tax relief to households by reducing individual tax rates, allowing a larger standard deduction, and expanding the child tax credit, all of which have encouraged workers to re-enter the labor market and entrepreneurs to start businesses.

On the monetary policy side, the Federal Reserve’s Federal Open Market Committee (FOMC) pursued a cycle of monetary tightening from December 2015 until June 2019, a period that saw the Federal funds rate target raised from the historically low range of 0 to 0.25 percent to a range of 2.25 to 2.50 percent. On July 31, 2019, however, the FOMC cut the target range for the first time in over 10 years, reducing the target range by 25 basis points to 2.0 to 2.25 percent. In the following two meetings, the FOMC cut the target range by a combined 50 basis points, bringing the range to 1.50 to 1.75 percent by late October 2019. In its October statement, the FOMC signaled a pause in rate cuts, and maintained this range at its December 2019 and January 2020 meetings. The January statement noted that “the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions, and inflation near the [Fed’s 2 percent target].”